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**MANAGEMENT'S DISCUSSION  
AND ANALYSIS—  
Required Supplementary Information  
(Unaudited)**

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## Management's Discussion and Analysis

In this section of the State of South Carolina's annual report, we provide a narrative overview and analysis of the State's financial performance for its accounting year (*fiscal year*) that ended June 30, 2003. Please read it together with the financial statements, which follow this section.

### Overview of the Financial Statements

This discussion and analysis provides an introduction to the State of South Carolina's basic financial statements, which include the following parts: (1) *government-wide financial statements*, (2) *fund financial statements*, (3) *component unit financial statements*, and (4) *notes to the financial statements*. This report also contains certain *required supplementary information* and other supplementary information.

### Government-wide Financial Statements

The government-wide statements present a long-term view of the State's finances *as a whole*, using *accrual-basis accounting*—the same accounting methods that most businesses use. The basic government-wide financial statements are on pages 33 through 125 of this report.

There are two government-wide financial statements:

***Statement of net assets:*** This statement presents information on *all* of the State's assets and liabilities, both short-term (*current*) and long-term (*non-current*). In addition, the statement reports the difference between assets and liabilities as *net assets*. Over time, increases or decreases in net assets may indicate whether the State's financial health (*financial position*) is strengthening or weakening. However, the statement of net assets does not tell the whole story. To assess the State's overall financial health, you would also need to consider factors such as the State's economy and the condition of its *capital assets* such as its buildings and *infrastructure* (roads and bridges).

***Statement of activities:*** This statement presents information showing how the State's overall net assets changed during the year. The State reports a change in its net assets as soon as an underlying event occurs that would cause a change. The statement of activities accounts for all current-year revenues and expenses, regardless of when the State received or paid cash. Although governments compile the statement of activities using accounting methods similar to businesses, this statement's format is quite different from the format of a business's income statement. The statement of activities can help to show how much it costs the State to provide various services. It also can help to show the extent to which each government function covers its own costs through user fees, charges, or grants. The *net revenue (expense)* column on the far right of this statement shows how much a particular function relies on taxes and other general revenues to finance its programs.

The government-wide statements report three different kinds of *activities*:

***Governmental activities:*** Most of the State's basic services are included here, such as general government, education, health and environment, social services, administration of justice, and intergovernmental (State aid to local governmental entities, including aid to the State's public school system). Taxes (primarily income and sales taxes) and federal grants finance most of these services.

***Business-type activities:*** These activities usually recover all, or a significant portion, of the costs of their services or goods by charging fees to customers. Higher education (State-supported colleges and universities), unemployment compensation benefits, financing of housing facilities, and financing of student loans are the most significant of South Carolina's business-type activities.

***Component units:*** Although component units are legally separate from the State, the State's elected officials are financially accountable for them. The Public Service Authority (Santee-Cooper, an electric utility company), the State Ports Authority, the Connector 2000 Association, Inc. (which operates the Southern Connector, a toll road), and the Lottery Commission are the State's major component units. Some financial information for these component units is included in this report. You also can obtain complete financial statements for these component units from their respective administrative offices (see Note 1a of the notes to the financial statements).

### Fund Financial Statements

The fund financial statements on pages 40 through 63 of this report provide detailed information about the State's most significant funds—not the State as a whole. Funds are accounting devices that the State uses to track specific funding sources and spending for particular purposes. South Carolina, like other governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The State reports three types of *funds*:

***Governmental funds:*** The State reports most of its basic services in governmental funds. Governmental funds account for activities that the State reports as *governmental activities* in its government-wide statements. These funds focus on *short-term* inflows and outflows of expendable resources. The balances remaining at the end of the year help determine whether a fund has more or less financial resources available to spend in the near future. Because the governmental fund statements lack the additional long-term focus of the government-wide statements, we provide a reconciliation that explains the relationship (or differences) between the two kinds of statements. By comparing the two kinds of statements and examining the reconciliation, you may better understand the long-term impact of the State's near-term financing decisions.

The basic governmental fund statements are on pages 40 through 47 of this report.

***Proprietary funds:*** Proprietary funds charge customers for the services they provide—whether

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they are outside customers (*enterprise funds*) or other State agencies or other governments (*internal service funds*). Proprietary funds use *accrual basis accounting* like businesses. The State reports all of its enterprise funds as *business-type activities* in the government-wide statements. However, because our internal service fund operations primarily benefit governmental funds, they are included as *governmental activities* in the government-wide financial statements.

The basic proprietary fund statements are on pages 48 through 61 of this report.

**Fiduciary funds:** The State is the trustee, or *fiduciary*, for its employees' retirement plans. The State also is responsible for other assets that, because of a trust agreement, it can use only for trust beneficiaries. We *exclude* these activities from the State's government-wide financial statements because the State cannot use these assets to finance its operations. The State is responsible for ensuring that the net assets it reports in fiduciary funds are used for their intended purposes.

The basic fiduciary fund statements are on pages 62 and 63 of this report.

### Component Unit Financial Statements

The *Government-wide Financial Statements* section above lists the State's major component units. More detailed financial statements for these component units are on pages 64 through 67 of this report.

### Notes to the Financial Statements

Immediately following the financial statements are *notes* that help explain some of the information in the financial statements and provide more detailed data. The notes on pages 71 through 125 are necessary to fully understand the financial statements.

### Required Supplementary Information

This section includes certain *required* reporting information that supplements the basic financial statements. Included in this section is a schedule that compares the State's legally adopted budget for the General Fund with actual revenues collected and expenditures paid for the year. Following the schedule, at the end of the notes to the required supplementary information, is a reconciliation that helps explain the differences between the *budgetary-basis* budget funds and the *GAAP-basis* reported in the governmental fund statements. This section also includes schedules related to the State's National Guard Pension System. This required supplementary information is on pages 127 through 135 of this report.

### Government-wide Financial Analysis

*Exhibits 1 and 2* summarize the State's overall financial position and results of operations for the past two years based on information included in the government-wide financial statements.

Exhibit 1

State of South Carolina's Net Assets as of June 30, 2003, with Restated Comparative Data as of June 30, 2002  
(Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals— Primary Government		Total Percentage Change
	2002	2003	2002	2003	2002	2003	2002-2003
<b>Assets</b>							
Current and other assets.....	\$ 5,947,937	\$ 5,826,749	\$ 3,564,834	\$ 3,628,526	\$ 9,512,771	\$ 9,455,275	(0.6%)
Capital assets.....	10,178,240	10,973,503	2,205,705	2,430,956	12,383,945	13,404,459	8.2%
<b>Total assets.....</b>	<b>16,126,177</b>	<b>16,800,252</b>	<b>5,770,539</b>	<b>6,059,482</b>	<b>21,896,716</b>	<b>22,859,734</b>	<b>4.4%</b>
<b>Liabilities</b>							
Long-term liabilities.....	4,297,085	4,567,721	2,088,293	2,174,106	6,385,378	6,741,827	5.6%
Other liabilities.....	2,778,287	2,909,443	679,617	832,297	3,457,904	3,741,740	8.2%
<b>Total liabilities.....</b>	<b>7,075,372</b>	<b>7,477,164</b>	<b>2,767,910</b>	<b>3,006,403</b>	<b>9,843,282</b>	<b>10,483,567</b>	<b>6.5%</b>
<b>Net Assets</b>							
Invested in capital assets, net of debt....	7,621,846	8,077,945	1,551,604	1,648,504	9,173,450	9,726,449	6.0%
Restricted.....	2,431,538	2,385,607	1,291,069	1,187,558	3,722,607	3,573,165	(4.0%)
Unrestricted.....	(1,002,579)	(1,140,464)	159,956	217,017	(842,623)	(923,447)	(9.6%)
<b>Total net assets.....</b>	<b>\$ 9,050,805</b>	<b>\$ 9,323,088</b>	<b>\$ 3,002,629</b>	<b>\$ 3,053,079</b>	<b>\$ 12,053,434</b>	<b>\$ 12,376,167</b>	<b>2.7%</b>

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### Net Assets

As we noted earlier, net assets may serve, over time, as a useful indicator of the State's financial position. For the 2002-2003 accounting year, the State's net assets totaled \$12.376 billion.

The largest portion of the State's net assets reflects its investment in capital assets (for example, buildings, roads, and bridges), less any related debt used to acquire those assets that is still outstanding. The State uses these capital assets to provide services to citizens; consequently, they are *not* available for future spending. Further, the State cannot sell the capital assets themselves to pay off the related debt because it needs the assets for its operations; so it must find other resources to pay off the debt.

*Restricted* net assets generally are available for future spending but are subject to external restrictions (such as bond covenants, federal government grant restrictions) or restrictions imposed by enabling State legislation or through State constitutional provisions. The State's largest restricted balances include capital improvement bond proceeds (restricted for various capital projects), and loan program funds (restricted

primarily for local government water and sewer projects).

The remaining *unrestricted* net assets—resources available for future spending—reported a *deficit* balance of \$923.447 million. The overall *negative* unrestricted net assets balance resulted from the \$1.140 billion deficit that the governmental activities reported. This deficit largely consisted of the following: (1) \$828.843 million in long-term debt to finance capital assets that are not on the State's financial statements because they belong to local governments, (2) a \$220.021 million deficit related to the use of Tobacco Settlement bond proceeds for operating purposes, and (3) an accumulated General Fund deficit of \$146.370 million. Please see Note 4 in the notes to the financial statements for a more detailed explanation of the deficit reported for the State's governmental activities.

The State's *business-type activities*, on the other hand, reported a *positive* \$217.017 million unrestricted net asset balance. This resulted from net positive balances of \$435.531 million associated with higher education and certain other business-type activities. However, that positive balance was offset by a \$218.514 million deficit related to the State-run medical malpractice insurance program.

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Exhibit 2

## State of South Carolina's Changes in Net Assets For the Fiscal Year Ended June 30, 2003, with Restated Comparative Data for the Fiscal Year Ended June 30, 2002 (Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals— Primary Government		Total Percentage Change
	2002	2003	2002	2003	2002	2003	2002-2003
<b>Revenues</b>							
Program revenues:							
Charges for services.....	\$ 1,543,457	\$ 1,500,240	\$ 2,402,503	\$ 2,813,392	\$ 3,945,960	\$ 4,313,632	9.3%
Operating grants and contributions.....	4,472,482	5,041,709	523,672	429,283	4,996,154	5,470,992	9.5%
Capital grants and contributions.....	514,815	516,167	29,635	47,381	544,450	563,548	3.5%
General revenues:							
Individual income tax.....	2,357,050	2,282,464	—	—	2,357,050	2,282,464	(3.2%)
Retail sales and use tax.....	2,788,909	2,820,520	—	—	2,788,909	2,820,520	1.1%
Other taxes.....	1,271,326	1,323,521	—	—	1,271,326	1,323,521	4.1%
Unrestricted grants and contributions.....	37,744	82,721	—	—	37,744	82,721	119.2%
Unrestricted investment income.....	79,119	29,535	—	—	79,119	29,535	(62.7%)
Tobacco legal settlement.....	88,290	86,313	—	—	88,290	86,313	(2.2%)
Other.....	70,137	71,621	—	—	70,137	71,621	2.1%
<b>Total revenues.....</b>	<b>13,223,329</b>	<b>13,754,811</b>	<b>2,955,810</b>	<b>3,290,056</b>	<b>16,179,139</b>	<b>17,044,867</b>	<b>5.4%</b>
<b>Expenses</b>							
Governmental activities:							
General government.....	1,548,072	1,485,190	—	—	1,548,072	1,485,190	(4.1%)
Education.....	920,695	1,110,675	—	—	920,695	1,110,675	20.6%
Health and environment.....	3,888,356	4,142,255	—	—	3,888,356	4,142,255	6.5%
Social services.....	798,409	846,818	—	—	798,409	846,818	6.1%
Administration of justice.....	693,478	676,157	—	—	693,478	676,157	(2.5%)
Resources and economic development.....	221,644	202,982	—	—	221,644	202,982	(8.4%)
Transportation.....	400,646	473,086	—	—	400,646	473,086	18.1%
Intergovernmental.....	3,807,548	3,686,361	—	—	3,807,548	3,686,361	(3.2%)
Other.....	71,883	76,130	—	—	71,883	76,130	5.9%
Business-type activities:							
Higher education.....	—	—	2,270,359	2,460,589	2,270,359	2,460,589	8.4%
Higher education institution support <sup>a</sup> .....	—	—	717,480	728,103	717,480	728,103	1.5%
Unemployment compensation benefits.....	—	—	526,954	546,389	526,954	546,389	3.7%
Financing of housing facilities.....	—	—	125,422	133,632	125,422	133,632	6.5%
Medical malpractice insurance.....	—	—	78,949	50,113	78,949	50,113	(36.5%)
Financing of student loans.....	—	—	36,748	41,409	36,748	41,409	12.7%
Tuition prepayment program.....	—	—	33,862	27,208	33,862	27,208	(19.7%)
Patriots Point development.....	—	—	6,717	6,986	6,717	6,986	4.0%
Insurance claims processing.....	—	—	1,467	1,603	1,467	1,603	9.3%
Other.....	—	—	28,362	25,452	28,362	25,452	(10.3%)
<b>Total expenses.....</b>	<b>12,350,731</b>	<b>12,699,654</b>	<b>3,826,320</b>	<b>4,021,484</b>	<b>16,177,051</b>	<b>16,721,138</b>	<b>3.4%</b>
<b>Excess (deficiency) before transfers and special and extraordinary items.....</b>	<b>872,598</b>	<b>1,055,157</b>	<b>(870,510)</b>	<b>(731,428)</b>	<b>2,088</b>	<b>323,729</b>	<b>15,404.3%</b>
Special and extraordinary items.....	—	—	(6,851)	(996)	(6,851)	(996)	85.5%
Transfers.....	(862,126)	(782,874)	862,126	782,874	—	—	N/A
<b>Increase (decrease) in net assets.....</b>	<b>10,472</b>	<b>272,283</b>	<b>(15,235)</b>	<b>50,450</b>	<b>(4,763)</b>	<b>322,733</b>	<b>N/A</b>
<b>Net assets, beginning of year.....</b>	<b>9,040,333</b>	<b>9,050,805</b>	<b>3,017,864</b>	<b>3,002,629</b>	<b>12,058,197</b>	<b>12,053,434</b>	<b>0.0%</b>
<b>Net assets, end of year.....</b>	<b>\$ 9,050,805</b>	<b>\$ 9,323,088</b>	<b>\$ 3,002,629</b>	<b>\$ 3,053,079</b>	<b>\$ 12,053,434</b>	<b>\$ 12,376,167</b>	<b>2.7%</b>

<sup>a</sup> The higher education institution support activity represents associations, foundations, and authorities created for the benefit of the State's higher education institutions.

## Changes in Net Assets

The State's net assets increased \$322.733 million, or 2.7% over the prior year's net assets.

## Governmental Activities

Net assets of the State's governmental activities increased by \$272.283 million, or 3.0%. Governmental activities' revenues are derived

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mostly from taxes; grants and contributions, including federal aid; and charges for goods and services. *Exhibit 3* illustrates the sources of revenues that these activities reported.

Governmental activities' expenses were mostly associated with services provided for health and environment, intergovernmental, general government, and education. *Exhibit 4* compares the cost of these services with their *program revenues*—revenues derived directly from the program itself or from parties outside the State's taxpayers or citizenry. The difference between the two represents the *net cost* of these services that taxes and other general revenues financed. Intergovernmental expenses of \$3.686 billion represent aid provided to local governments, including local school districts; taxes and other general revenues entirely supported these expenses. This aid includes formula-based State revenue sharing, aid to local school districts for public education, and subsidies to reimburse counties for the State's residential property tax relief program. For the accounting year ended June 30, 2003, the State used \$5.642 billion in tax and other general revenues to finance the net cost of all services that the State's governmental activities provided. Governmental activities reported \$782.874 million in net transfers to the State's business-type activities, most of which represents support provided to the State's public colleges and universities.

The following paragraphs highlight the most significant changes in revenues, expenses, and net transfers for governmental activities during the 2002-2003 accounting year:

- Operating grants and contributions increased by \$569.227 million, or 12.7%, over last year. This increase related to increases in federal grant revenues and in contributions for education from the Lottery Commission. Federal Medicaid funding increased due to rising health costs and increased client participation. In addition, the percentage of federal funding for Medicaid expenses increased as a result of the

Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). Federal funds for food stamp benefits were greater as a result of higher unemployment in the State. Lottery contributions increased significantly during this first full year of lottery operations. Lottery sales also grew in response to the introduction of the multi-state Powerball game and other new games.

- Unrestricted grants and contributions increased \$44.977 million, or 119.2%, because of the receipt of unrestricted, population-based grant revenues from the federal government under the JGTRRA of 2003.
- Unrestricted investment income declined \$49.584 million, or 62.7%, because the State had less cash to invest, interest rates were lower, and the State moved from longer-term to shorter-term investments.
- Education expenses rose \$189.980 million, or 20.6%. Lottery-based scholarships paid to the State's colleges and universities accounted for the majority of the increase during this first year of lottery-based scholarship funding.
- Transportation expenses increased \$72.440 million, or 18.1%, as the State Department of Transportation spent bond proceeds received in a prior fiscal year on various highway maintenance projects.
- Various program expenses, such as those for general government, administration of justice (prisons and public safety), resources and economic development, and intergovernmental (revenue-sharing with local governments) were less than the previous year, primarily because of General Fund budget cuts.
- Net transfers to business-type activities declined \$79.252 million, or 9.2%, because General Fund budget cuts reduced State funding of higher education.

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Exhibit 3  
Governmental Activities Revenues

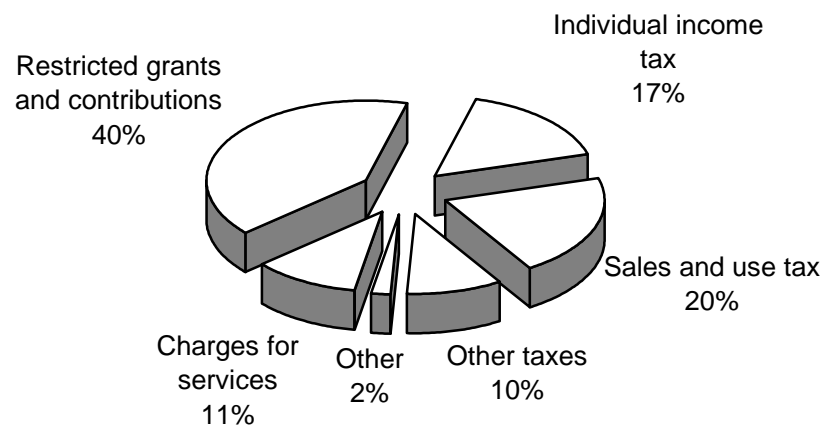
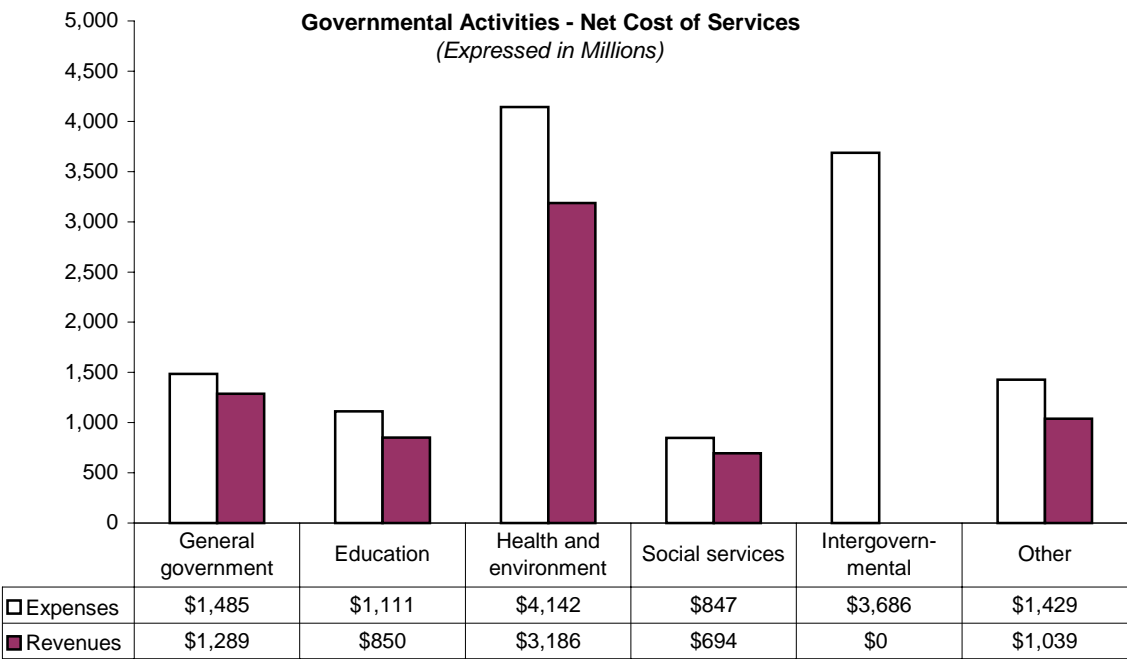


Exhibit 4  
Governmental Activities - Net Cost of Services  
(Expressed in Millions)



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## Business-type Activities

Net assets of the State's business-type activities increased \$50.450 million, or 1.7%.

Business-type activities' revenues included charges for services (85.5%) and grants and contributions (including federal aid) (14.5%). Business-type activities' expenses were mostly to provide higher education services and support (79.3%), unemployment compensation benefits (13.6%), and housing services (3.3%).

Most business-type activities are self-supporting. Tuition and student fees, research and other grants (both private and governmental), and other charges primarily pay for the services that the Higher Education Fund provides. The Higher Education Fund, however, receives substantial resources (primarily transfers of annual appropriations) from the State's governmental activities. Essentially, net transfers to the Higher Education Fund represent the cost of educational services that taxes and other general revenues of governmental activities support.

The following paragraphs highlight the most significant changes in revenues, expenses, and net transfers for business-type activities during the 2002-2003 accounting year:

- Charges for services increased \$410.889 million, or 17.1%. This was primarily because of increases for higher education and unemployment compensation activities. Revenues of State-supported colleges and universities were up significantly because of tuition and fee increases and increased enrollment. Institutions raised tuition and fees to help offset a reduction in State appropriations. Higher education revenues also increased because of lottery-funded scholarships that for the first time became available to in-State students who met certain requirements. In addition, the largest universities reported an increase in federally funded research grants. Unemployment compensation assessments experienced a 0.5% base rate increase in

January 2003. Higher unemployment and the related increase in unemployment claims led to the increase in assessments.

- Operating grants and contracts declined \$94.389 million, or 18.0%. This decrease mostly came from a decline in federal grants for unemployment compensation benefits. The State received \$109.412 million in surplus federal funds through a Reed Act distribution last year but did not receive any surplus funding this year.
- Higher education expenses increased \$190.230 million, or 8.4%, over last year. This increase was primarily due to first-year expenses of the lottery-funded scholarship program, additional costs associated with increased enrollment, and increases in employee compensation.
- Medical malpractice insurance expenses declined \$28.836 million, or 36.5%. The program incurred an unusually large amount of claims in 2001-2002 but saw a return in 2002-2003 to claims levels more in line with the 2000-2001 levels.
- Net transfers received from governmental activities decreased by \$79.252 million, or 9.2%. This represents a reduction in State appropriation funding to State-supported colleges and universities due to budget cuts.

## Financial Analysis of the State's Funds

The State of South Carolina uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Within the fund financial statements, the focus is on reporting major funds.

### Governmental Funds

*Exhibit 5* shows the components of fund balance for the State's various governmental funds as of June 30, 2003.



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*Exhibit 5*  
**State of South Carolina's Governmental Fund Balances**  
*(Expressed in Thousands)*

	General Fund	Departmental General Operating	Local Government Infrastructure	Department of Transportation Special Revenue	State Tobacco Settlement	Nonmajor Governmental Funds	Total Governmental Funds
Reserved.....	\$ 57,982	\$ 936	\$ 1,494,124	\$ 8,815	\$ 2,250	\$ 138,745	\$ 1,702,852
Unreserved, designated.....	—	—	—	—	—	120,604	120,604
Unreserved, undesignated.....	(204,352)	295,666	(163,760)	(5,719)	536,991	404,658	863,484
<b>Totals.....</b>	<b>\$ (146,370)</b>	<b>\$ 296,602</b>	<b>\$ 1,330,364</b>	<b>\$ 3,096</b>	<b>\$ 539,241</b>	<b>\$ 664,007</b>	<b>\$ 2,686,940</b>
 Change from prior year...	 \$ (6,419)	 \$ 52,656	 \$ 77,721	 \$ (187,681)	 \$ (129,585)	 \$ (49,071)	 \$ (242,379)
Percentage change.....	(4.6%)	21.6%	6.2%	(98.4%)	(19.4%)	(6.9%)	(8.3%)

As the exhibit shows, at June 30, 2003, the State's governmental funds' ending fund balance was \$2.687 billion, which represents a decrease of \$242.379 million (or 8.3%) from the prior year. Almost half of this total (45.1%) makes up the *unreserved* fund balance—the amount available for spending in the coming year. The remaining fund balance, or 54.9%, is *reserved* and is *not* available for future appropriation because it is accessible only for specific purposes. The following paragraphs discuss the major governmental funds that had significant changes in fund balance:

The *General Fund* is one of two large State operating funds. This fund includes resources that pay for the services that the State traditionally has provided to its citizens. These resources, such as taxes, are accounted for in the General Fund unless State law requires them to be accounted for in another fund. During the 2002-2003 accounting year, the total fund balance of the General Fund decreased by \$6.419 million, or 4.6%, from last year. That is, the General Fund spent more than it took in, even though its revenues increased and its expenditures decreased relative to the previous year. Budget cuts and the receipt of unrestricted federal aid under the Jobs and Growth Tax Relief Reconciliation Act of 2003 helped stabilize fund balance, but offsetting negative factors were at work as well. For example, individual income tax revenues lagged behind last year because of higher unemployment and reduced corporate earnings. In addition, investment earnings decreased and debt service expenditures increased.

The *Department General Operating Fund* accounts for resources, other than General Fund resources, that State agencies may use for operating

purposes. These resources include significant amounts of federal grant receipts. Fund balance increased by \$52.656 million, or 21.6%, over last year, in part because the State received additional federal Medicaid funding at the end of the 2002-2003 accounting year under the federal Jobs Growth and Tax Relief Reconciliation Act of 2003.

The *Department of Transportation (DOT) Special Revenue Fund* accounts for various gasoline taxes, fees, fines, and federal grant resources. The DOT uses these resources to pay for its general operations, which include highway maintenance, regulation, and construction of public highways and bridges. The decrease in fund balance of \$187.681 million resulted primarily because during 2002-2003, the DOT spent bond proceeds it originally had received in a previous accounting year.

The *State Tobacco Settlement Fund* accounts for revenues received from the General Fund and from the Tobacco Settlement Revenue Management Authority, a blended component unit and nonmajor governmental fund designated to receive and manage the State's share of the multi-state legal settlement with the tobacco industry. Fund balance declined \$129.585 million during 2002-2003 because the fund's health-related expenditures for the year exceeded its interest and investment earnings.

## Proprietary Funds

*Exhibit 6* shows the components of net assets for the State's various proprietary funds.

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Exhibit 6

## State of South Carolina's Proprietary Fund Net Assets (Expressed in Thousands)

Fund Net Assets	Enterprise Funds						Internal Service Funds
	Higher Education	Unemployment Compensation	Housing Authority	Education Assistance Authority	Nonmajor Enterprise	Total Enterprise	
Invested in capital assets (net of related debt).....	\$ 1,535,579	\$ —	\$ 73	\$ 95	\$ 112,757	\$ 1,648,504	\$ 125,437
Restricted, expendable.....	217,530	535,674	222,928	127,300	35,771	1,139,203	87,972
Restricted, nonexpendable.....	29,155	—	—	—	19,200	48,355	353
Unrestricted.....	332,097	—	965	1,064	(105,402)	228,724	(103,355)
<b>Totals.....</b>	<b>\$ 2,114,361</b>	<b>\$ 535,674</b>	<b>\$ 223,966</b>	<b>\$ 128,459</b>	<b>\$ 62,326</b>	<b>\$ 3,064,786</b>	<b>\$ 110,407</b>
 Change from prior year..	 \$ 158,070	 \$ (139,047)	 \$ 11,674	 \$ 4,980	 \$ 18,937	 \$ 54,614	 \$ (95,556)
Percentage change.....	8.1%	(20.6%)	5.5%	4.0%	43.6%	1.8%	(46.4%)

The State has two kinds of proprietary funds: enterprise funds and internal service funds. *Enterprise funds* are reported as business-type activities in the government-wide financial statements. Enterprise funds sell goods or services primarily to parties outside of State government.

The *Higher Education Fund*, an enterprise fund, accounts for the general operations of ten four-year higher education institutions and sixteen area technical colleges. Fund net assets increased \$158.070 million, or 8.1%, over last year. This total increase included a \$76.645 million, or 5.3%, increase in capital assets, net of related debt, and a \$62.255 million, or 23.1%, increase in unrestricted net assets. Capital assets, net of related debt, increased because of the completion of several large construction projects. Some of these projects are discussed in the *Capital Assets* subsection of the discussion and analysis. Unrestricted net assets represent resources that can be used for the institutions' on-going operations. The increase in this portion of net assets primarily was due to significant increases in tuition and student fees, increased enrollment, and an increase in federal research grants and contracts.

The *Unemployment Compensation Fund* experienced a significant decline in fund balance during the accounting year ended June 30, 2003. This fund collects assessments from employers and uses these resources to pay benefits to unemployed persons who are legally eligible to receive such benefits. The fund's net assets decreased \$139.047 million (20.6%) from the preceding year. The economic downturn put more people out of work, so the fund paid out more benefits. In addition, the fund earned less interest income than last year because it had less cash and because interest rates were lower.

South Carolina's *internal service funds* provide certain services (including maintenance, insurance, printing, data processing, and motor pool services) and some goods (such as office supplies) primarily

to other State funds but sometimes to local governments as well. The objective of an internal service fund is to charge its customers for the costs of the services or goods that it provides. Because internal service funds primarily benefit State government, South Carolina reports them as governmental activities in the government-wide financial statements.

## Budgetary General Fund Highlights

Differences between the original budget and the final amended budget were substantial.

The State's *Board of Economic Advisors (BEA)* is responsible for forecasting revenues for the budget. State law requires that the BEA meet at least quarterly to review revenue collections and to adjust its estimates if necessary. During the 2002-2003 accounting year, the BEA revised original revenue estimates downward by \$478.491 million, or 8.7%. These downward revisions were the result of unrealistic revenue forecasts as well as slower than expected economic growth.

If the BEA reduces revenue projections significantly, the State's *Budget and Control Board* (the Board) is responsible for reducing spending to keep the budget in balance. In response to the BEA's revised estimates, the Board reduced appropriations by \$518.200 million by eliminating a 2.0% set-aside for capital and nonrecurring items and by ordering 8.7% cuts for most State agencies. Appropriations had to be increased by \$31.961 million during the year to fund certain State-mandated programs that were underestimated in the Appropriation Act.

Even with these substantial reductions to the original budget, actual revenues at June 30, 2003, were \$82.153 million less than the revised expected revenues. Furthermore, actual revenues fell short of actual expenditures by \$26.780 million. The State was forced to expend *all* of the remaining

## Management's Discussion and Analysis

\$38,797 million from its "rainy day account," fully depleting that account. Despite these deficit-avoidance actions, the State ended the year with a budgetary fund *deficit* of \$131,227 million. See the *Budgetary Reporting* subsection of the *Required Supplementary Information* section on pages 128 through 133 of this report for a detailed budgetary comparison schedule.

### Capital Assets and Debt Administration

#### Capital Assets

At the end of the 2002-2003 accounting year, the State had \$13.404 billion invested in capital assets. This represented a net increase (including additions and deductions) of \$1.020 billion, or 8.2%, over the previous accounting year (see Exhibit 7).

Exhibit 7  
State of South Carolina's Capital Assets  
(Net of Depreciation, Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals—Primary Government		Total Percentage Change
	2002	2003	2002	2003	2002	2003	2002-2003
Land and improvements.....	\$ 648,770	\$ 858,814	\$ 184,799	\$ 201,018	\$ 833,569	\$ 1,059,832	27.1%
Infrastructure.....	5,174,989	5,647,697	—	—	5,174,989	5,647,697	9.1%
Buildings and improvements.....	844,698	890,319	1,479,836	1,709,790	2,324,534	2,600,109	11.9%
Vehicles.....	178,065	181,426	8,688	9,099	186,753	190,525	2.0%
Machinery and equipment.....	121,666	112,180	176,442	198,575	298,108	310,755	4.2%
Works of art and historical treasures.....	974	3,667	19,064	19,029	20,038	22,696	13.3%
Construction in progress.....	3,202,996	3,258,002	331,024	288,409	3,534,020	3,546,411	0.4%
Intangible assets.....	6,082	21,398	5,852	5,036	11,934	26,434	121.5%
<b>Total.....</b>	<b>\$ 10,178,240</b>	<b>\$ 10,973,503</b>	<b>\$ 2,205,705</b>	<b>\$ 2,430,956</b>	<b>\$ 12,383,945</b>	<b>\$ 13,404,459</b>	<b>8.2%</b>

## Management's Discussion and Analysis

As in the previous accounting year, the State's investment in land increased significantly during 2002-2003, because it acquired rights-of-way for highway construction and widening projects and it purchased several parcels of land and easements for conservation purposes.

The State's infrastructure investment also increased significantly during the 2002-2003 accounting year. The \$232.000 million Carolina Bays Parkway opened in December 2002, and an Interstate-85 widening project was completed at a cost of approximately \$70.000 million. The State also installed median cable barriers on the State's interstates. Construction continues on the Cooper River Bridge project and various road-widening projects.

The State's investment in buildings and improvements increased significantly, partly because public universities completed several large construction projects. The University of South Carolina had the largest increase to its reported buildings because it completed a new multi-purpose entertainment arena and a 170,000 square-foot

fitness and wellness center. Also, Clemson University renovated its recreation and wellness center and various athletic facilities.

Intangible assets increased from last fiscal year, primarily because the Department of Public Safety implemented its new Project Phoenix software system in Department of Motor Vehicle offices statewide.

See Note 8 in the notes to the financial statements within this report for additional information on the State's capital assets.

### Long-term Debt

At the end of the accounting year, the State had \$6.513 billion in bonds and notes outstanding—an increase of \$444.586 million, or 7.3%, over last year (see *Exhibit 8*). Note 13, in the notes to the financial statements, includes more detailed information about the State's long-term debt.

*Exhibit 8*  
State of South Carolina's Outstanding Bonds and Notes  
(Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals—Primary Government		Total Percentage Change
	2002	2003	2002	2003	2002	2003	2002-2003
Backed by the State:							
General obligation bonds.....	\$ 2,204,129	\$ 2,239,207	\$ 134,235	\$ 208,968	\$ 2,338,364	\$ 2,448,175	4.7%
Bond anticipation notes.....	—	—	8,400	—	8,400	—	(100.0%)
Backed by specific revenues:							
Revenue bonds and notes.....	4,398	33,429	1,574,598	1,643,188	1,578,996	1,676,617	6.2%
Infrastructure Bank bonds.....	1,193,046	1,463,582	—	—	1,193,046	1,463,582	22.7%
Tobacco Authority bonds.....	902,920	869,870	—	—	902,920	869,870	(3.7%)
Limited obligation bonds.....	30,597	27,040	—	—	30,597	27,040	(11.6%)
Bond anticipation notes.....	—	—	16,400	28,025	16,400	28,025	70.9%
<b>Total.....</b>	<b>\$ 4,335,090</b>	<b>\$ 4,633,128</b>	<b>\$ 1,733,633</b>	<b>\$ 1,880,181</b>	<b>\$ 6,068,723</b>	<b>\$ 6,513,309</b>	<b>7.3%</b>

## Management's Discussion and Analysis

New debt resulted mainly from the issuance of \$285.195 million in Infrastructure Bank revenue bonds. The State Infrastructure Bank uses its own revenues to pay the principal and interest (*debt service*) on these bonds. These revenues are primarily truck registration fees and penalties that the Department of Public Safety collects and transfers to the Bank.

Three bond rating services assign ratings to bonds that the State backs with its own taxing authority (*general obligation bonds*). Standard & Poor's and Fitch, Inc., rate these bonds as "AAA," and Moody's Investors Service rates them as "Aaa." These are the highest ratings that these services assign. In September 2003, Moody's revised the outlook for the State from stable to negative. In announcing the change in outlook, Moody's stated: "The negative outlook reflects a trend of weakened revenues resulting from continued slowing in the State's economy, which has led to multi-year General Fund year-end deficits."

The State limits the amount of annual payments for principal and interest on general obligation bonds and notes rather than directly limiting the amount of those bonds and notes that the State may have outstanding. At June 30, 2003, the State legally could issue additional bonds as long as the new debt would not increase the State's annual principal and interest payments by more than the following amounts: \$11.131 million in total for all institution bonds, \$22.012 million for highway bonds, and \$24.978 million for general obligation bonds, excluding institution and highway bonds. (*Institution bonds* are general obligation bonds that benefit the State's Higher Education Fund.)

### Economic Factors and Next Year's Budget

#### The "Rainy Day Account"

At June 30, 2003, the General Reserve Fund, sometimes called the *rainy day account*, had a zero balance instead of the \$147.708 million that would have been in the reserve had it been fully funded at that date. The State's Constitution requires restoration of the reserve to full funding within three years after a withdrawal. State law defines full funding for the reserve as 3% of the Budgetary General Fund's revenues for the latest completed accounting year.

#### Budgetary General Fund for the 2003-2004 Accounting Year and Mitigation of the 2002-2003 Operating Deficit

On August 15, 2003, based on current-year and prior-year revenue collection trends, the State's

Board of Economic Advisors (BEA) declared a revenue shortfall for the 2003-2004 accounting year. As a result, the BEA adjusted its revenue estimate for the Budgetary General Fund downward by \$112.976 million from the amount included in the annual Appropriation Act.

On August 20, 2003, the State Budget and Control Board ordered \$141.804 million in spending reductions for 2003-2004. As required by Section 11-11-325 of the Code of Laws, the first \$98.599 million of this cut eliminated the entire 2.0% "set-aside" for capital and nonrecurring purposes. In accordance with Section 63.18 of the 2003-2004 Appropriation Act and Section 6 of Act 356 of 2002, the Board ordered an additional \$43.205 million in budget cuts for State agencies to help mitigate the Budgetary General Fund's 2002-2003 operating deficit as well as any anticipated 2003-2004 shortfall in revenue. The cuts will reduce most agencies' spending in 2003-2004 by approximately 1.0%.

See the *Budgetary General Fund Highlights* subsection above for additional information about the responsibilities of the BEA and the State Budget and Control Board.

### Economic Conditions

The State's Budgetary General Fund revenue collections through the first five months of the 2003-2004 accounting year were \$50.725 million, or 2.4%, higher than the level collected in the same period in 2002. For July through November 2003, retail sales tax collections were 6.8% greater than July through November 2002 receipts, while net individual income tax collections were up 1.4% over the same period. Year-to-date net corporate income tax collections were up 109.5%, or \$16.106 million, for July through November 2003 as compared to the same period in 2002.

The BEA adopted a preliminary Budgetary General Fund revenue estimate of \$5.491 billion for the 2004-2005 accounting year. This revenue forecast represents a 2.0% increase over the revised base for 2003-2004 but is roughly \$4.000 million less than 2003-2004's appropriated base. The BEA will review this estimate in February 2004 and either adjust or finalize it then.

### Requests For Information

The primary purpose of this financial report is to provide South Carolina's citizens, taxpayers, customers, investors, and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. Please address your questions concerning information in this report as follows:

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